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FISCAL IMPACT STATEMENT

LS 6547
BILL NUMBER: SB 286

NOTE PREPARED: Feb 20, 2004
BILL AMENDED: Feb 19, 2004

SUBJECT: Taxation.

FIRST AUTHOR: Sen. Ford
FIRST SPONSOR: Rep. Klinker

BILL STATUS: CR Adopted - 2nd House

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State

Summary of Legislation: (Amended) *Research Expense Income Tax Credit:* This bill extends the research expense income tax credit indefinitely.

Rehabilitation Deductions: The bill allows a property owner to determine the year in which a five year residential rehabilitation property tax deduction period begins and allows a property owner to revive a deduction not taken for the assessment date in 2003 or an earlier year. It also amends the definition of rehabilitation. This bill allows the inclusion of certain market data in the application for a deduction.

Rental Unit Deduction: The bill provides that the property tax deduction for a building that contains principal rental dwellings is equal to the number of units multiplied by $2,000.

Standard Homestead Deduction: This bill increases the standard deduction for homesteads by $2,000.

Farmland Credit: The bill also establishes a farmland property tax credit and it makes an appropriation to distribute an amount to taxing units equal to the amount of farmland property tax credits granted in the taxing units.

PTRC and Homestead Credit Limit: This bill provides that the payment of Property Tax Replacement Credits (PTRC) plus Homestead Credits may not exceed $2,000 for a homeowner in a year.

Effective Date: July 1, 2004.

Explanation of State Expenditures: (Revised) *PTRC and Homestead Credit:* The overall impact to the state Property Tax Replacement Fund (PTRF) from all provisions of the bill is estimated to be an increase in state expenditures of about $2.0 M to $5.3 M in FY 2005 and $6.0 M to $16.0 M in FY 2006.The following table summarizes the changes.

Estimated Change in Property Tax Replacement Fund Expenditures		
Provision	**FY 2005**	**FY 2006**
Rental Unit Deduction	$150,000	$450,000
Standard Homestead Deduction	(1,500,000)	(4,450,000)
Farmland Credit	23,333,350	70,000,000
PTRC and Homestead Credit Limit	(16.7 M) to (20.0 M)	(50 M) to (60 M)
Total PTRF Expense Impact	$2.0 M to $5.3 M	$6.0 M to $16.0 M

(Revised) *Rental Unit Deduction:* **The change in expenditures from the Property Tax Replacement Fund caused by the rental deduction is estimated at an increase of $150,000 in FY 2005 and $450,000 per year thereafter.**

The new deductions for rental property in this proposal would cause an increase in homesteaders' property tax bills which would result in an additional cost to fund the homestead credit. The homestead credit expenditure increase is estimated at $325,000 in FY 2005 and $970,000 per year thereafter.

The increased deductions would also cause part of rental property tax burdens to be shifted to business personal property beginning in CY 2005. The state pays the 60% school general fund PTRC on all property, however, business personal property does not qualify for the regular 20% PTRC. The state's expense for PTRC would be reduced by an estimated $175,000 in FY 2005 and $520,000 in all other years.

(Revised) *Standard Homestead Deduction:* **The state would have reduced expenditures for PTRC and Homestead Credit expenditures under the standard homestead deduction provision, estimated at $1.5 M in FY 2005 and $4.5 M per year following.**

The increased deductions for homesteads in this proposal would cause a reduction in homesteaders' property tax bills which would result in a reduced cost to fund the homestead credit. The homestead credit expenditure reduction is estimated at $1.2 M in FY 2005 and $3.6 M per year thereafter.

The increased deductions would also cause part of homeowners' tax burdens to be shifted to business personal property beginning in CY 2005. Therefore, the state's expense for PTRC would be reduced by an estimated $280,000 in FY 2005 and $835,000 in all other years.

(Revised) *Farmland Credit:* Under this provision, farms that are at least 10 acres in size and owned by an individual (or a family) and is actively farmed by the individual (or family) may be eligible for a credit against property taxes on the farm land. Beginning in CY 2005, the credit would equal $70 M per year, statewide. The $70 M would be distributed to eligible farms on a pro-rata basis using the average assessed value per acre with a maximum of 250 acres per owner. A farmland owner may receive the credit on only one farm in the state. The credit would be paid from the Property Tax Replacement Fund. **The cost of the credit would be $23.33 Min FY 2005 (partial year) and $70 M per year thereafter.** The bill appropriates $23.33

M in FY 2005.

(Revised) *PTRC and Homestead Credit Limit:* Under this bill, beginning in CY 2005, homeowners would not be able to receive more than $2,000 per year in combined PTRC and Homestead Credits. It is estimated that this limitation would reduce PTRF expenditures by between $50M and $60 M per year beginning in CY 2005. On a fiscal year basis, the reduction in PTRF expenditures from the limitation are estimated at $16.7 M to $20.0 M in FY 2005 (partial year), and $50 M to $60 M in following years.

Explanation of State Revenues: *Research Expense Income Tax Credit:* This credit is currently set to expire on December 31, 2013. This bill would eliminate the expiration date and make this credit permanent. It is difficult to estimate the exact impact of continuing this tax credit indefinitely since it is dependent on both the amount of research expenses individual taxpayers make during the year and their total tax liability. This permanent extension would affect revenue collections beginning in FY 2014 and years after.

Background: P.L. 242-2002 (ss) increased this credit from 5% to 10% of qualified expenses for tax years beginning January 1, 2003, and eliminated the apportionment factor used to calculate the credit. P.L. 224-2003 extended this tax credit until December 31, 2013. The total estimated cost of this credit at the higher rate is expected to range from approximately $50 M to $75 M annually. Over the past six years when the credit was set at a 5% rate, the Research Expense Credit has ranged from a low of $9.2 M in FY 1996 to a high of $24.2 M in FY 1999. In FY 2000 $19.4 M were claimed, and in FY 2001 $21.9 M were claimed at the 5% rate. No data is available on the amount of credits which might be claimed under the changes made by P.L. 242-2002(ss).

With additional incentives created for research and development activity based in the state of Indiana, the revenue loss from this credit could increase by an indeterminable amount. The credit provides $100,000 for each $1 M in new research expenses. Increased expenditures on research activities could also generate additional Adjusted Gross Income and Sales Tax revenue if these expenses are used to hire additional employees or purchase related equipment.

The Research Expense Tax Credit affects revenue collections deposited in the General Fund and the Property Tax Replacement Fund.

(Revised) *Property Tax deductions:* The state levies a small tax rate for State Fair and State Forestry. Any reduction in the assessed value base will reduce the property tax revenue for these two funds. **The total state property tax revenue reduction under this bill is estimated at $44,000 in FY 2005 (partial year) and $88,000 in all other years.** These revenue losses are broken down as follows:

(Revised) *Rental Unit Deduction:* The reduction in state revenue caused by the rental deduction is estimated at $17,000 in FY 2005 (partial year) and $34,000 per year beginning in FY 2006.

(Revised) *Standard Homestead Deduction:* The reduction in state revenue caused by the rental deduction is estimated at $27,000 in FY 2005 (partial year) and $54,000 per year beginning in FY 2006.

Explanation of Local Expenditures:

Explanation of Local Revenues: (Revised) *Rehabilitation Deductions:* Under current law, the residential property rehabilitation deduction equals up to $9,000 AV per unit for five years. This deduction only applies if the total assessed value prior to rehabilitation did not exceed $18,000 AV for a single-unit home, $24,000 for a two-family home, or $9,000 per unit for a dwelling with more than two units. The historic property rehabilitation deduction for structures at least 50 years old currently equals up to $60,000 AV for single-family dwellings and up to $300,000 AV for any other type of property.

These deductions may be claimed for five years beginning with the year in which the increase in AV from the rehabilitation occurs. For rehabilitation before 2004, this bill would allow a taxpayer who never filed, but qualified, for the deduction to still claim a full five years. In addition, for claims regarding rehabilitation that occurs after 2003, taxpayers would be permitted to file for a deduction in any year after they are qualified. The deduction would last for 5 years including the initial year in which it was filed.

Rehabilitation is currently defined as significant repairs, replacements, or improvements intended to increase the livability, utility, safety, or value of the property under the rules of the Department of Local Government Finance. This bill would change the definition to "repairs, replacements, remodelings, additions, or other improvements that increase the value of the property. Repairs would no longer need to be "significant and the definition would not be tied to a DLGF rule.

The bill would also allow taxpayers to include with an application for rehabilitation deduction, market value appraisals from before and after the rehabilitation and general market value data on the type of rehabilitation done to assist the township assessor.

These provisions could increase deduction levels for the above deductions for about 5 years by an unknown amount. The value of rehabilitation deductions is commingled with real property abatements on the auditor's abstract, making it impossible to quantify the current deductions. The total of all real property abatements plus rehabilitation deductions in 2002 was $2.0 B AV. Real property abatements most likely make up the overwhelming majority of this aggregate number, leaving a smaller amount representing rehabilitation deductions.

(Revised) *Rental Unit Deduction:* Under this proposal, each building containing rental property would be eligible for a property tax deduction of up to $2,000 for each rental unit in the building. According to Census, there are about 709,100 rental units in Indiana. At $2,000 each, the total deduction is estimated at $1,420 M AV.

The rental deduction would cause a net property tax shift from rental properties to all properties in the approximate amount of $28.1 M in CY 2005 and $27.3 M in CY 2006. Approximately 30% of this amount ($8.4 M in CY 2005) would be shifted to homeowners.

Total local revenues, except for cumulative funds, would remain unchanged. The revenue for cumulative funds would be reduced by the product of the fund rate multiplied by the AV reduction amount applicable to that fund.

(Revised) *Standard Homestead Deduction:* Under this proposal, the standard homestead deduction would be increased from the current $35,000 to $37,000 beginning in CY 2005. The $2,000 increase in the deduction would result in a reduction of assessed value estimated at $2,270 M AV in CY 2005 and years following.

The additional standard homestead deduction would cause a property tax shift from homeowners to all properties in the approximate amount of $45.0 M in CY 2005 and $43.7 M in CY 2006. Approximately 30% of this amount would actually be shifted back to homeowners bringing the net shift from homeowners to other property types to about $31.5 M in CY 2005 and $30.6 M in years following.

Total local revenues, except for cumulative funds, would remain unchanged. The revenue for cumulative funds would be reduced by the product of the fund rate multiplied by the AV reduction amount applicable to that fund.

State Agencies Affected: Department of State Revenue; Department of Local Government Finance.

Local Agencies Affected: County and township assessors; County auditors.

Information Sources: Department of State Revenue; Census of Farming and Dataset: SF3, Tables H7 and H30, U.S. Census Bureau; Local Government Database.

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